



Governor's Blue Ribbon Tax Commission
July 24, 2012: Northern Kentucky Public Hearing
Comments from the NKY Chamber of Commerce and
Tri-County Economic Development Corporation (NKY Tri-ED)

Kentucky has an opportunity to take a close look at the realities of state taxes and develop a system that will help ensure the long-term sustainability of needed government programs while building taxpayers' confidence of how their money is being spent. We are appreciative of the opportunity to present in front of the Commission and hope to offer insight into the needs of the business community for the attraction, retention and creation of jobs into the Commonwealth's economy.

Overriding all tax code and tax incentive issues is the ominous cloud of doubt that envelopes Kentucky due to its unfunded pension and retirement health care liability problem. Called one of five "sinkhole" states by the Institute for Truth in Accounting, a non-partisan, non-profit entity, Kentucky is facing serious issues in this realm. Each taxpayer in Kentucky would have to shell out \$23,500 to pay KY's obligations.

High Priority Tax Code Recommendations from the NKY Chamber of Commerce and NKY Tri-ED:

A. Make the Tax Collection System More User Friendly

To make the tax collection system more user-friendly, the Commonwealth should begin by reducing the multiple layers of tax and separate filing requirements imposed on taxpayers. This system should be designed to tax either gross receipts or income tax, but not both. A system of collection based on gross receipts will require far less informational reporting and provide auditors from the Commonwealth a more efficient approach to auditing taxpayers.

The Commonwealth should also play a role in municipal and county tax reform. A system of statutory law that is consistently applied among all Commonwealth municipalities and counties should be adopted to make for seamless collection

and uniformity. Tax collection forms should be consistent in form and manner among all municipalities and counties.

B. Modify the Kentucky Corporate Income Tax

One of the key reasons that a Fortune 500 Headquarters, Omnicare, left Kentucky in 2012 was due to the changes in Kentucky's Corporate Income Tax structure that took effect on 1/1/12. Kentucky mandated a "nexus consolidated reporting" regime as part of its 2005 reduction in the overall corporate income tax rate from a maximum of 8.25% down to 6.0%.

The significant increase in tax resulting from the transition to the nexus consolidated reporting methodology is most notably due to (1) a change in the composition of the affiliated entities that comprise the reporting group, (2) the lack of elimination of transactions between corporations now excluded from the nexus consolidated group, and (3) the new limitation on the utilization of losses within the nexus consolidated group. These changes, both alone, or in the aggregate, result in Kentucky taxable income that does not truly reflect the results of a headquartered company's business with operations throughout the country or the world.

The resultant loss of a Fortune 500 company needs to be addressed. Modifications in the corporate income tax structure to reduce or eliminate the effects of "mandatory nexus consolidated reporting" need to be undertaken.

C. Implement the Individual Angel Tax Credit

Twenty-seven (27) other states permit a state personal income tax credit for qualified angel investments by individuals. Kentucky only allows such a credit for angel investors that are part of a qualified fund, or group of investors. HB 113 in the 2012 General Assembly addressed this issue. Over 70 House representatives signed on as co-sponsors for this bill and it received an unanimous vote of approval from the House Economic Development Committee, yet it failed to get called for a vote in the House Appropriations and Revenue Committee. Implementation of this tax credit is necessary to spur innovation and entrepreneurship in Northern Kentucky and across the Commonwealth, in both rural and urban areas.

Additional Recommendations:**A. Reduce Tangible Personal Property and Sales Taxes on Data Centers**

Northern Kentucky has the ingredients for success in attracting and growing data centers – a power-rich energy grid, talent support through the NKY College of Informatics, suitable sites – except for burdensome property and sales taxes. Kentucky needs to be able to compete better against other states, including Ohio, that eliminate local and state property taxes across all taxing districts for major data centers. Further, a reduction or elimination of sales taxes on new equipment purchased for data centers needs to be instituted.

Manufacturing entities enjoy built-in tax code advantages, or commonly called “as-of-right incentives” in Kentucky due to a long-standing notion that high value purchases for manufacturing should not be burdened with normal tangible personal property tax rates nor with regular Kentucky sales taxes. This should not change.

Based on actual experience with a major data center project, Northern Kentucky Tri-ED revealed high tax impact barriers. This data center project planned to incur cumulative expenditures of \$328 million in data center equipment over a ten year period. The annual real and tangible personal property taxes and sales taxes would amount to **\$2.3M**. By contrast, manufacturing firms would pay only **\$213K in property taxes and zero in sales taxes, or 196% less**. See the table below:

Projected 10-Year Equipment Expenditures	10 Yr. State and Local Property and KY Sales Taxes	
	Data Center	Manufacturer
\$328,000,000	\$23,277,799	\$213,528

Kentucky’s only means to reduce this high tax burden for data centers is through the issuance of Industrial Revenue Bonds (IRBs) with a possible Payment in Lieu of Taxes (PILOT) agreement. By virtue of ownership of IRB financed equipment, a local government can exempt some or all of the property tax burden. But with the approval needed of five to seven taxing jurisdictions, this is a tedious, time-consuming and expensive process to undergo to reduce the property tax burden.

Ohio is one adjoining state that eliminated tangible personal property taxes on machinery and equipment in 2005 through tax reform. So, statutorily, Ohio has no tangible property tax for data centers. For sales taxes, Ohio provided in 2011 a tax credit opportunity for computer data centers (See [ORC 122.175](#)), which is similar to Kentucky’s exemption for manufacturing operations. In Ohio, a full or partial sales and use tax exemption may be granted for equipment used in the operation of a computer data center business. To qualify for the exemption, a business must make a capital investment of at least \$100 million in Ohio and

maintain an annual payroll for employees involved in the project of at least \$5 million.

“Kentucky’s Unbridled Future,” our current strategic plan, has designated “Data Centers” as part of a Technology target industry. The trouble is, we are not as competitive as we need to be regarding taxation of high value data centers. [Site Selection’s 2011 feature article](#) on Data Centers did not include Kentucky as a state highly interested in the attraction of these prized projects.

B. Adopt a Single Sales Factor Apportionment Formula in Kentucky’s Corporate Income Tax

The combined local and state corporate income tax burden is still among the highest in the country. Kentucky should join five other neighboring states in adopting a single sales apportionment formula. Under Kentucky’s current double-weighted sales factor apportionment formula, companies are penalized for creating jobs and capital investment in Kentucky. The Kentucky Chamber advocates this position.

C. Repeal or phase out the inventory tax

Property taxes on business inventory, abandoned by most states, serve as a disincentive to business growth because they tax the investment itself rather than the outcome or profit from that investment. Furthermore, some types of inventory are exempt by law or enjoy exemption because of location, while other, similar inventory does not receive the same treatment. The Kentucky Chamber advocates this position.

D. Eliminate sales tax on postage for printers

The federal Streamlined Sales Tax Act (SSTA) initially in 2002 permitted sales tax charges on postage affixed to printed materials. Only three (3) states have not eliminated this requirement, with Kentucky being one. With Ohio and Indiana do not have this tax and this negatively impacts business opportunities for printing operations in Kentucky. HB 97, which would eliminate the effect of the SSTA in Kentucky, was introduced in the 2012 General Assembly that received a cursory hearing before the House A & R Committee. To level the playing field, Kentucky needs to adopt this provision.

E. Job Retention Tax Credit for Office, Service and Technology Jobs

While manufacturing projects have two job retention tax credit programs -- the Kentucky Reinvestment Act (KRA) and the Kentucky Industrial Revitalization Act (KIRA) -- no such program exists for Office, Service and Technology jobs.

Attachment #2 outlines a corporate income tax proposed tax credit to retain essential primary industry jobs beyond manufacturing.

F. Collect Non-Resident Withholding Taxes

Kentucky should emulate Ohio and require that for "S Corporations", wages paid to shareholders owning more than 20% of the corporation (whether resident or non-resident) should be included in income allocation for apportionment purposes. As in the case of Ohio reciprocity would not apply.

- Example:

- o XYZ Construction, Inc. (an "S Corporation") located in Ohio, also performs construction work in Kentucky. Added to Federal Taxable Income would be the salaries paid to any 20% shareholders of the "S Corporation". John James, CEO, an Ohio Resident owns 51% of XYZ Construction, Inc. and was paid a salary of \$250,000. That salary would be added to Federal Taxable Income to determine the amount of income to be apportioned to Kentucky.

There are several basic points that should be kept in mind during this process:

1. We've just experienced the worst economy in more than 75 years, resulting in revenue shortages for Kentucky and most other states.
2. Kentucky's competitiveness has to be the key priority of this Commission when assessing modifications to the tax code.
3. We can't just look at taxes; we have to look just as hard at state spending. State spending has grown faster, on average, than the state's economy over the past 20 years. With so much money being spent on programs like state employee pension and insurance costs, it has limited our ability to invest in economic development principles like education and infrastructure.

As outlined by the Kentucky Chamber of Commerce in its recommendations to the Tax Commission, the NKY Chamber and NKY Tri-ED would like to echo the KY Chamber's sentiment in that taxes significantly impact business decisions that lead to job creation and retention. Therefore, as the Commission assesses its research and begins the tough task of making formal recommendations, we'd hope you would approach tax reform in accordance with the following principles:

- **Support growth and competitiveness:** Kentucky's state and local tax system should support growth-oriented tax policies that improve the competitiveness of Kentucky businesses in the national and global marketplace.
- **Reduce the cost of capital:** The tax code should encourage investment, as it is the key to increased growth and productivity as well as higher wages for Kentuckians.
- **Simplify tax code:** The tax code should be simplified with the goal of reducing compliance costs for the private sector. Complex taxes impose costs on businesses that either reduce the return on investment or are passed on to consumers and workers.
- **Promote fairness:** Kentucky's tax system should promote fairness by creating a level playing field on which Kentucky businesses can compete. Double taxation, or pyramiding, should be prohibited, and tax expenditures should be carefully studied to determine effectiveness.
- **Revenue neutral changes:** Changes in the state tax code should be revenue neutral and undertaken only to increase fairness and competitiveness and not to simply generate additional state revenue. While tax changes cannot guarantee tax neutrality for every Kentucky business, the goal should be not to raise net taxes on the business community.
- **Continue to focus on spending:** To keep taxes competitive, it is critical to examine expenditures and align them with economic realities. Reforming the tax code must be coupled with a continued commitment by the legislature to reform and prioritize government spending.